STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
NEIL J. MIGLIORE	:	DETERMINATION
for Redetermination of a Deficiency or for Refund of Unincorporated Business Tax under Article 23 of the Tax Law for the Years 1967 and 1968.	:	

Petitioner, Neil J. Migliore, c/o Jerome J. Feldman, 249-12 Jericho Turnpike, Floral Park, New York 11001, filed a petition for redetermination of a deficiency or for refund of unincorporated business tax under Article 23 of the Tax Law for the years 1967 and 1968 (File No. 801587).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on July 12, 1989 at 9:15 A.M., with all briefs and documents to be filed by August 31, 1989. Petitioner appeared by Jerome J. Feldman, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation's assertion of deficiencies based upon Federal audit changes was proper and whether petitioner has shown wherein such audit was in error.

II. Whether the Division of Taxation, upon withdrawing the asserted deficiency for fraud, sustained its burden of proving that lesser penalties should be imposed.

FINDINGS OF FACT

Petitioner, Neil J. Migliore, and his wife, Rose Migliore, filed a New York State Combined Income Tax Return and a U.S. Individual Income Tax Return for the year 1967. On each return, Mr. Migliore reported that he was an outside sales representative and that he received commission income in the amount of $15,000.00.

Petitioner and his wife filed a New York State Income Tax Resident Return and a U.S. Individual Income Tax Return for the year 1968. Mr. Migliore again reported that he was an outside sales representative and that he received commission income in the amount of $20,000.00.

In or about 1967, petitioner was arrested on criminal charges pertaining to gambling.

Petitioner's gambling activities led the Internal Revenue Service to recalculate petitioner's income. For the years 1967 and 1968, the Internal Revenue Service found that petitioner's annual gross receipts were $3,600,000.00 on the basis of average monthly receipts of $300,000.00. It also found that petitioner incurred annual operating expenses of $3,240,000.00. Therefore, the Internal Revenue Service concluded that petitioner had additional annual income of $360,000.00 during the years 1967 and 1968. For the year 1967 alone, the Internal Revenue Service also found that petitioner had additional wage income of $1,300.00. However, for both years, the Internal Revenue Service determined that petitioner was liable for a penalty for fraud on the additional unreported income.

On April 6, 1972, the Internal Revenue Service issued a notice which advised Mr. and Mrs. Migliore that they were liable for a deficiency of tax of $249,009.10, plus a penalty for fraud of $124,504.55 for the year 1968. It is not clear whether the Internal Revenue Service issued a notice to petitioner for the year 1967.

The findings of the Internal Revenue Service were conveyed to the Division of Taxation ("Division") and, as a result, the Division issued a Notice and Demand, dated August 23, 1976, which assessed personal income tax and unincorporated business tax in the amount of $121,296.00. The notice, which stated that it was based on Federal audit changes, also asserted penalties for fraud. In or about June 1984, the Division cancelled the Notice and Demand.

On July 17, 1984, the Division issued a Statement of Audit Changes which explained that petitioner had a deficiency of unincorporated business tax for the years 1967 and 1968. The notice, which was also based on the Federal audit changes, further explained that the Division considered petitioner's income from his commissions and gambling business to be

subject to unincorporated business tax. It also stated that in order to conform with Federal audit results, penalties were imposed pursuant to Tax Law § 685(c) for underestimation of unincorporated business tax and Tax Law § 685(e) for fraud.

On October 17, 1984, the Division issued a Notice of Deficiency to petitioner asserting a deficiency of unincorporated business tax in the amount of $34,950.00, plus penalty of $18,525.60 and interest of $43,817.26, for a total amount due of $97,292.86. The notice was based upon the Statement of Audit Changes dated July 17, 1984.

Petitioner filed a petition challenging the Notice of Deficiency. In its answer to the petition the Division requested that if it failed to prove fraud, then penalties for failure to file a tax return and for negligence should be imposed. Later, at the hearing, the Division withdrew the fraud penalty and asserted, in the alternative, penalties for failure to file an unincorporated business tax return, for failure to pay unincorporated business tax and for negligence.

SUMMARY OF PETITIONER'S POSITION

At the hearing, petitioner's representative testified that, according to newspaper accounts, the Suffolk Police Department raided petitioner's home in 1968 and found betting slips representing from one day to three days' activity. Thereafter, based on these betting slips, the Internal Revenue Service determined that tax was due for the years 1967 and 1968. Petitioner submits that, according to these newspaper accounts, the police did not find any bank accounts, brokerage accounts, savings accounts or indicia of standard of living to indicate that petitioner had the level of income which had been calculated by the Internal Revenue Service.

Petitioner's representative further explained that, as of the date of the hearing, petitioner had not paid any of the Federal taxes which were asserted to be due. Moreover, Mr. Migliore never challenged the income tax portion of the New York State assessment because he was in jail. Petitioner's representative contends that a refund due to petitioner was applied by New York to satisfy his income tax liability, but that petitioner had voluntarily paid other income tax liabilities.

At the conclusion of the hearing, petitioner's representative was given the opportunity to

submit a copy of the newspaper articles which had been mentioned. However, these newspaper articles were not presented. In its place, petitioner's representative offered a notarized statement from a private investigator which stated that on November 8, 1971 petitioner was convicted on an indictment which contained counts pertaining to operating a policy business, possession of policy slips, bookmaking and possession of bookmaking records. On December 17, 1971, petitioner was sentenced to a year in jail and a $500.00 fine for each count. Petitioner also presented a Certificate of Release of Federal Tax Lien. This document stated that the Federal lien arising from taxes which had been assessed for the years 1967 and 1968 was released.[1]

CONCLUSIONS OF LAW

A. During the period in issue, Tax Law § 659 provided, in pertinent part, as follows:

> "If the amount of a taxpayer's federal taxable income...reported on his federal income tax return for any taxable year...is changed or corrected by the United States internal revenue service or other competent authority...the taxpayer...shall report such change or correction in federal taxable income...within ninety days after the final determination of such change, correction, ...or as otherwise required by the tax commission, and shall concede the accuracy of such determination or state wherein it is erroneous."

B. In this instance, petitioner has not challenged the conclusion that there was a final Federal determination of a change in taxable income. In addition, petitioner did not contest the Division's assertion that the Federal determination was not reported to New York State as required by Tax Law § 659. In view of petitioner's failure to comply with Tax Law § 659, the Division's issuance of the Notice of Deficiency herein was proper.

C. At the hearing, petitioner argued that the deficiency asserted by the Division was arbitrary because it was based on an arbitrary Federal determination. Specifically, petitioner argued that the deficiency for 1967 was infirm because it was based on finding betting slips for 1968. After the hearing, petitioner's representative changed his argument upon learning that petitioner was convicted of a gambling offense in 1967. Petitioner's post-hearing brief questions how the seizure of records in 1967 provides the basis for an assessment in 1968.

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[1]At the hearing, petitioner's representative stated that the Federal lien had expired.

D. During the years in issue, section 681(a) of the Tax Law authorized the Division to estimate a taxpayer's taxable income and the tax due thereon from any information in its possession when a return is not filed.[2] However, the Division's estimation of a taxpayer's income must have a rational basis (see, e.g., Matter of Fortunato, Tax Appeals Tribunal, February 22, 1990). If a notice of deficiency does not have a rational basis, it must be cancelled (Matter of Fortunato, supra; Matter of DiLorenzo, State Tax Commission, October 6, 1978).

The documentation from the Internal Revenue Service does not show how the $300,000.00 average monthly revenues were determined. It also does not reveal the method by which the annual operational expenses of $3,240,000.00 were calculated. On the other hand, the explanation proffered by petitioner's representative also fails to cast additional light on the subject. The difference in the explanation regarding how the audit was conducted creates doubt in the confidence one has in the accuracy of petitioner's representative's explanation. It is also noted that reliance upon one's memory of newspaper accounts of an event which occurred over 20 years ago is questionable.

It is recognized that petitioner's representative stated that he also relied on conversations with petitioner's attorney and petitioner. However, since no details of these conversations were provided, they do not add any additional support for the explanation provided by petitioner's representative.

E. On the basis of the foregoing, it is concluded that the record does not establish how the Internal Revenue Service calculated petitioner's revenue and expenses. In fact, it is not clear from the record that petitioner's conviction in 1967 was the event which caused the Internal Revenue Service to recalculate petitioner's income. Therefore, the question becomes whether a notice of deficiency which was issued on the basis of information provided by the Internal Revenue Service, without knowing the basis for that information, should be sustained.

Internal Revenue Code § 6103(d) authorizes the disclosure of return information to a state

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[2]This provision was made applicable to unincorporated business tax pursuant to former section 722 of the Tax Law.

agency charged with the responsibility of auditing state revenues. Similarly, Tax Law § 697(f) authorizes cooperation between the Internal Revenue Service and New York State with respect to information on returns. In view of the express statutory authority for the use of information gathered from the Internal Revenue Service, it is concluded that reliance on this information was reasonable. Therefore, the burden has shifted to the taxpayer to establish that the notice of deficiency was improper (cf. Matter of Fortunato, supra). Here, petitioner has not presented any evidence to conclude that the amount of tax assessed was incorrect. Therefore, petitioner has not sustained his burden of proof of establishing that the amount of tax assessed was erroneous. In this regard, it is noted that it is irrelevant that the Internal Revenue Service cancelled its lien.

F. As stated earlier, the Division withdrew its assertion of a penalty for fraud and requested, in the alternative, that penalties be imposed for failure to file an unincorporated business tax return, failure to pay unincorporated business tax and for negligence.

During the years in issue, Tax Law § 685(a) had not been divided into separate paragraphs. Rather, this section provided as follows:

> "Failure to file tax return.--In case of failure to file a tax return under this article on or before the prescribed date (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return five per cent of the amount of such tax if the failure is for not more than one month, with an additional five per cent for each additional month or fraction thereof during which such failure continues, not exceeding twenty-five per cent in the aggregate. For this purpose, the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed upon the return."

During the years in issue, Tax Law § 685(b) provided:

> "Deficiency due to negligence.--If any part of a deficiency is due to negligence or intentional disregard of this article or rules or regulations hereunder (but without intent to defraud), there shall be added to the tax an amount equal to five per cent of the deficiency."

G. The Division may assert penalties for failure to file a return or for negligence as an alternative to the fraud penalty in its answer or at the hearing (see, Matter of Ilter Sener d/b/a Jimmy's Gas Station, Tax Appeals Tribunal, May 5, 1988). However, when the Division asserts an alternative penalty, a primary concern is the adequacy of the notice (see, Matter of Anton's

Car Care Center, Ltd., Tax Appeals Tribunal, November 23, 1988).

In this instance, petitioner has not alleged or demonstrated surprise or prejudice. Moreover, petitioner did not request an opportunity to present new or different evidence. Therefore, it is determined that the alternative penalties were properly asserted.

H. When the Division waits until after the usual determination procedure to assert an alternative penalty, the burden of proof of establishing the propriety of the penalty is upon the Division (Matter of Ilter Sener, supra). In order to sustain its burden of proof with respect to the penalty asserted pursuant to Tax Law § 685(a), the Division must show that petitioner's omissions were due to willful neglect and not due to reasonable cause (see, Pickett v. Commr., 34 TCM 213). An affirmative showing must also be made in order to sustain the Division's burden of proof with respect to the negligence penalty (see generally, Langston v. Commr., 36 TCM 1703). In this instance, the Division has not presented any evidence which would show that petitioner understood the need to file unincorporated business tax returns or what the reason for the nonfiling and nonpayment was. Therefore, the Division has failed to sustain its burden of proof establishing the propriety of the penalties asserted pursuant to Tax Law § 685(a) and (b).

I. The petition of Neil J. Migliore is granted to the extent of Conclusion of Law "I" and the Division is directed to adjust the Notice of Deficiency, dated July 17, 1984, in accordance therewith; and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE